

## 212 GUIDE TO INVESTMENT AND FINANCE

prosperous ventures to the formation of a sinking fund, or a reserve.

A sinking fund, in the ordinary form, is not generally feasible for an ordinary investor of moderate means, if only on the ground that the continuous reinvestment of small sums at compound interest cannot usually be attempted with success ; but a sinking fund in the form, of a reserve—applicable to the retrieval of losses—should be the practice of a prudent man.

It will be of interest to describe the customary nature and process of what are termed sinking funds proper. A sinking fund consists of a yearly (or other periodical) sum set apart and invested at compound interest (with the reinvestment of each payment of interest as\* it is received) for the purpose of recouping any loss of money which may occur, or with the object of providing the means for discharging a specific pecuniary obligation which may have been accepted. A few examples will show the operation of the process.

1. A security is purchased on the Stock Exchange which is redeemable at the end of thirty years (from the date of purchase) at par; that is, at the nominal capital-value which it expresses —usually £100 or some multiple of £100. Owing to favourable circumstances affecting the security and its prospects at the time of purchase, "the security is in great demand, and the investor pays a price of £104, or he purchases at a premium of 4 per cent. Since the bond will be redeemed or paid off at £100 only, provision should be made for the certain loss of the £4. Every sinking fund should be calculated at such a rate of interest as may, after allowance for income tax, depreciations of value, or actual losses on the securities in which its instalments are invested, be expected with reasonable confidence to be continuously realised throughout the duration of the period for which the service of the fund is required. This selection of the rate depends upon the sagacity and closeness of our predictions of the probable future course of the money market, and the influences by which it is affected, based upon a survey of the experience of the past. But, in any

event, the rate chosen for the accumulation of the fund should be low, and the securities in which its instalments are invested, and in which the interest derived from the investments of past instalments